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THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D. C. 20505

National Intelligence Officers

January 11, 1977

MEMORANDUM FOR: See Distribution

SUBJECT : The Emerging Role of the Soviet Merchant
Fleet in World Shipping

1. At the instigation of the Secretary of the Treasury, CIA's Office of Economic Research has prepared an intelligence memorandum on the impact of Soviet shipping practices on US and other Western merchant fleets, including the emerging role of the Soviet merchant fleet, and the validity of recent Western charges of unfair Soviet competition. The attached draft addresses these issues.

2. You or your designated representative are invited to a meeting to discuss the findings and conclusions of this draft which will be held at CIA Headquarters on Tuesday, January 25, 1977 at 1000 hours in Room 7E62. We welcome any comments or observations you are prepared to offer to this effort at that time.

3. Please call [redacted] by noon Monday, 24 January, to confirm attendance.

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National Intelligence Officer
for Economics

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Summary

Soviet penetration of the market for Western shipping services has increased in recent years -- largely as the result of rate cutting in the movement of liner cargo. Because of the high percentage of outmoded general purpose freighters in the Soviet liner fleet, however, Western business losses to the USSR thus far can only be described as irritating. Injuries from low Soviet freight charges have not been as serious as the complaints of European and Japanese liner operators would indicate. Planned fleet expansion through 1980 will heighten the competitive threat of Soviet ships to Western liners, but will affect only a narrow segment of the industry. In addition, fleet growth will permit the substitution of a sizable tonnage of new Soviet bulk ships for chartered foreign ships currently employed in Soviet foreign trade. As at present, the Soviet fleet's impact on the US will be confined to American ships in US liner trade..

At the end of 1975, the Soviet merchant fleet was ninth largest in the world with a capacity of 15.3 million deadweight tons (DWT), less than 3% of the world total. It was only slightly larger than the tenth ranked US-flag fleet. Although the chief function of the USSR's fleet is to carry Soviet domestic and foreign trade cargoes, the tonnage of cross trade cargoes -- goods it moves for foreign shippers between non-Soviet ports -- has been increasing rapidly and now constitutes more than 15% of carriage by the fleet. More important, although the fleet's biggest earnings derive from delivery of Soviet exports, revenues from cross trading made up 25% of the more than \$500 million contributed by the merchant fleet to the USSR's hard currency earnings in 1975.

The movement of cross trade cargo in scheduled liner service at cut rates by the USSR is causing deep concern among Western shipowners despite the predominance of uncompetitive general purpose ships in the Soviet fleet. Most complaints center on the rate cutting practices of Soviet lines that are now carrying about 3% of US liner trade with Japan and Western Europe (to the detriment of US and other Western lines) and of the USSR's Trans-Siberian Landbridge (TSLB), which has attracted about 8% of the container traffic between Europe and the Far East from European and Japanese lines in that trade.

Moscow is apparently taking steps to live up to its agreement with the US Federal Maritime Commission in July to moderate its rate cutting and collaborate with Western shipowners who are members of rate setting conferences on liner routes in US trade. The Baltic Steamship Company is joining seven liner conferences on the North Atlantic and the Far East Steamship Company -- which is revising its rate schedules to the US West Coast -- has begun talks with conferences on the North Pacific about conditions for membership. Such moves -- if followed through by Moscow -- will reduce and eventually eliminate the rate advantage of Soviet lines in competition with Western liner operators.

Soviet tankers and other tramp vessels operating on the charter market carry a larger volume of cross trade cargo than Soviet liners. Their activities seldom draw complaints because there are no established "rate structures" in the charter market.

Moreover, the volume of cross trade cargo carried by Soviet tramps is still less than the volume of Soviet exports and imports carried on chartered foreign ships.

Planned deliveries of 4.6 million DWT to the Soviet merchant fleet under the 1976-1980 Five Year Plan will upgrade a small portion of the Soviet liner fleet with modern ^{ro/ro}/vessels and full containerships. With greatest emphasis on ro/ro ships, some of them up to the highest Western standards, Soviet competition with Western ro/ro operators on some routes will be much more serious than any currently being encountered by US, European, and Japanese owners of containerships and other liner tonnage.

The heaviest deliveries under the new plan will consist of tankers and dry bulk carriers for the Soviet tramp fleet. By permitting Soviet ships to carry a higher percentage of the country's imports and exports, acquisition of these ships will greatly benefit the USSR's hard currency balance of payments. It will also take a large volume of business away from shipowners currently engaged in Soviet trade and further weaken the world charter market. The role of US ships in bilateral trade with the USSR will presumably not be affected, as long as the US/Soviet Maritime Agreement remains in effect.

I. The Soviet Merchant Fleet Today

Fleet Expansion

1. Since the USSR began its first intensive program of merchant fleet expansion in 1962, its merchant fleet has acquired 12.4 million DWT of new ships and grown -- after deductions for losses and retirements -- from 4.2 to 15.3 million DWT. There have been two periods of heavy deliveries: 1963-1966 and 1973-1975. During both, ship acquisitions averaged more than a million DWT a year. Prior to 1962, the highest annual deliveries were 600,000 DWT. Deliveries peaked at 1.3 million DWT in 1964 and came close to that level in both 1965 and 1975.

2. The build-up in the early 1960's resulted in the USSR's emergence as a world shipping power. Fleet capacity more than doubled from 1961 to 1966 (see Table 1) and the world standing of the Soviet merchant fleet rose from twelfth in 1962 to seventh in 1964. This rank was held until 1974, when stepped up deliveries to the French, Italian, and Panamanian fleets pushed the Soviet fleet down to tenth.

Fleet Size and Composition

3. At the end of 1975, the Soviet merchant fleet* with 1,650 vessels totalling 15.3 million dead-weight tons (DWT), ranked ninth in the world with close to 3% of total tonnage (see Table 2).

4. Dry cargo ships -- the backbone of the Soviet fleet -- accounted for nearly 10 million DWT, 65% of total tonnage. Of these, 6.7 million DWT or 43% of fleet capacity were vessels suitable for liner** service (see Table 3). General purpose dry cargo ships are the most common vessel types in this category, accounting for 6.5 million DWT. Although these general purpose ships are well suited for coastal deliveries to Soviet Far Eastern and Northern Sea Route ports and for trade with many LDCs, they are not competitive on major international routes such as the North Pacific, the North Atlantic, and Europe-Far East, where the faster and larger container and ro/ro ships of Western fleets predominate. At the end of 1975, full container and ro/ro ships made up only 2% of the Soviet liner fleet; none of these were as large or as fast as their Western counterparts.

* Excluding passenger vessels and vessels of the Danube and Caspian steamship companies that operate only on inland seas and waterways.

** Scheduled services that offer prescribed numbers of sailings per month for general cargo on given trade routes.

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Table 1

Soviet Merchant Fleet Size and Growth

<u>Year</u>	<u>Inventory as of 31 December</u>		<u>Net Increase in Tonnage</u>		<u>Deliveries During Year</u>
	<u>Number</u>	<u>Million Dead-weight Tons</u>	<u>Million Dead-weight Tons</u>	<u>Percent</u>	<u>Million Dead-weight Tons</u>
1959	590	3.3	0.3	6	0.4
1960	650	3.9	0.6	18	0.6
1961	680	4.2	0.3	8	0.4
1962	740	4.8	0.6	14	0.7
1963	820	5.7	0.9	19	0.9
1964	900	6.9	1.2	21	1.3
1965	990	8.0	1.1	16	1.2
1966	1,070	8.9	0.9	12	1.0
1967	1,150	9.7	0.8	9	0.8
1968	1,230	10.4	0.7	8	0.8
1969	1,310	11.2	0.8	7	0.8
1970	1,400	11.9	0.7	7	0.8
1971	1,440	12.3	0.4	3	0.5
1972	1,460	12.6	0.3	2	0.5
1973	1,520	13.4	0.8	6	1.0
1974	1,570	14.2	0.8	6	0.9
1975	1,650	15.3	1.1	8	1.2

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Table 2

World Fleet Tonnages, 31 December 1975

<u>Flag</u>	<u>Million DWT</u>	<u>Percent of World Fleet</u>
World Total	556.6	100.0
Liberia <u>1/</u>	132.7	23.8
Japan	63.2	11.4
United Kingdom	54.9	9.9
Norway	47.8	8.6
Greece	37.6	6.8
Panama <u>1/</u>	22.1	4.0
France	17.7	3.2
Italy	16.8	3.0
USSR	15.3	2.8
United States (active) <u>2/</u>	14.6	2.6
Other	133.9	24.0

1. The fleets of Liberia and Panama are "flag of convenience" fleets, owned by US, Greek, overseas Chinese, and other foreign firms. US firms have more than 30 million DWT under the Liberian flag, close to 5 million under the Panamanian flag, and at least 15 million under a variety of other foreign flags. Total US-owned tonnage thus exceeds 65 million DWT.

2. Excluding approximately 2.9 million DWT of obsolete government-owned tonnage in the reserve fleet.

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5. After cargo liners, tankers comprise the second largest component of the fleet -- 5 million DWT. Timber carriers form its next largest segment with a total capacity of 1.9 million DWT and 13% of total tonnage, followed by dry bulk carriers with 1.3 million DWT and 8% of total tonnage.

6.6. Because of the shallow depths at most Soviet ports -- few of which can handle dry cargo ships larger than 30,000 DWT or tankers over 50,000 DWT -- the average size of Soviet ships has always been well below world standards.

- ° On 31 December 1975, the average Soviet ship was 9,300 DWT compared with a world average of 25,000 DWT.
- ° Soviet tankers averaged 17,400 DWT compared with a world average of 57,000 DWT while dry bulk carriers averaged 11,600 DWT compared with a world average of 35,000 DWT.
- ° The average ship size in the USSR's small fleet of full containerships is about half that in the world fleet.
- ° Soviet ship sizes are close to world standards in their large fleet of general purpose cargo liners and small fleets of ro/ro and refrigerator ships.

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18. In managing its international cargo lines, the USSR has thus far preferred to operate as an independent outside the conference system.* As conference members, many Soviet lines would have lacked ships fast enough and modern enough to compete in terms of service, the principal form of competition between conference members. In mid 1976, only six Soviet cargo lines were affiliated with conferences and only one had joined a conference since 1973. The Soviets do join conferences when their ships are competitive -- as in a trade that has not been containerized -- and when they feel that their revenues will be maximized by accepting higher conference rates and a ceiling on their participation.

19. Soviet policy on conference membership may be changing. At a meeting between the leaders of the Soviet Ministry of the Maritime Fleet and the US Federal Maritime Commission (FMC) in July, the Soviets agreed to raise their liner rates in US trade at least as high as those of other non-conference operators and to seek membership in all appropriate conferences in US trade. Soviet officials met with representatives of major conferences operating on the North Atlantic in early September and agreed to have Baltatlantic -- the Soviet line operating between the US East Coast and Atlantic and Baltic ports in Europe --

*Conferences are organizations of steamship companies operating cargo lines on given trade routes. They set the rates charged by member lines and allot sailings among them. Non-conference lines often operate on the same routes as "independents" or "outsiders".

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join the seven conferences with jurisdiction on this lucrative route. No steps are known to have been taken to enroll other independent Soviet lines on the North Atlantic in conferences.

The Far East Steamship Company (FESCO) which operates on the North Pacific has, however, begun negotiations with conference lines in that trade. In the meantime, FESCO representatives in the US are changing the way that commodities are classified in their liner tariffs on file with the FMC so they can

align their rates with those of other independents.

20. Like other outsiders, Soviet lines outside the conference system undercut the conferences. Independent rates are traditionally 10%-15% below conference rates. Soviet rate discounts on certain commodities in certain trades far more than 15% below conference levels have led to claims by West European and Japanese conference members that Moscow offers liner rates below cost to attract business. Because cost data are not available on Soviet liner operations, such claims cannot be substantiated.

Current Impact of Soviet Shipping Practices on Non-Communist Shipowners

21. Western charges during 1975 of unfair competition from Soviet ships have centered on that portion of the USSR's sizable liner fleet serving on international lines -- about 3 million DWT out of a total of 6.6 million DWT. Soviet employment of its tankers and remaining dry cargo ships in tramp service on the world charter market has had little effect on that market or on Western owners.

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22. Despite their handicaps, Soviet ships have attracted close to 1 million tons of the US liner trade with Europe and the Far East -- 3% of the total -- from US and other conference operators in the trade. Cargo moved between Japan and Europe on the Trans-Siberian Landbridge in 1975 also constitutes a gain by the Soviet liner fleet at the expense of Western Liner operators in that trade. About 8% of all container between Europe and the Far East used the TSLB. The tonnage of international liner cargo carried by the Soviet fleet during 1975 in both Soviet trade and the cross trades was 12 million tons, about 2% of the world total. Soviet participation in the cross trades was less than half this amount.

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